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Dept. Of Commerce & Insurance
Company Examinations

REPORT ON EXAMINATION

OF THE

CONSUMERS INSURANCE USA, INC.

MURFREESBORO, TENNESSEE

AS OF

DECEMBER 31, 2002

THE DEPARTMENT OF COMMERCE AND INSURANCE

STATE OF TENNESSEE

NASHVILLE, TENNESSEE

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Murfreesboro,Tennessee
April 29, 2004

Honorable Alfred W. Gross
Chair, Financial Condition (E) Committee
Secretary, Southeastern Zone
National Association of Insurance Commissioners
Commissioner of Insurance
Commonwealth of Virginia
State Corporation Commission
Bureau of Insurance
P. O. Box 1157
Richmond, Virginia 23218

Honorable Sally McCarty
Secretary, Midwestern Zone
National Association of Insurance Commissioners
Commissioner
State of Indiana
Department of Insurance
311 W. Washington Street, Suite 300
Indianapolis, Indiana 46204-2787

Honorable Paula A. Flowers
Commissioner of Commerce and Insurance
State of Tennessee
500 James Robertson Parkway
Nashville, Tennessee 37243

Dear Commissioners:

Pursuant to your instructions and in accordance with the Tennessee Insurance Laws, regulations, and resolutions adopted by the National Association of Insurance Commissioners (NAIC), a financial examination and market conduct review has been made concerning the condition and affairs of hereinafter generally referred to as the Company, and a report thereon is submitted as follows:

SCOPE OF EXAMINATION

This examination was called by the Commissioner of Commerce and Insurance of the State of Tennessee through the Examination Tracking System of the NAIC and was scheduled to commence on May 26, 2003; however, actual examination work did not begin until August 25, 2003. The examination was conducted under the association plan of the NAIC by examiners from the State of Tennessee.

The examination was conducted at the Company's office in Murfreesboro, Tennessee where all books and records are located. The period covered by this examination is from January 1, 1999, to the close of business on December 31, 2002, and includes any material transactions and/or events occurring subsequent to the examination date and noted during the course of the examination.

The examination of the financial condition of the Company was conducted in accordance with guidelines and procedures contained in the NAIC Examiners Handbook.

During the course of examination, assets were verified and valued and liabilities were determined or estimated as of December 31, 2002. The

Company's financial condition and its degree of solvency were thereby established. Test checks, covering selected periods, were made of income and disbursement items and a general review was made of the Company's operations, practices and compliance with statutes, to the extent hereinafter set forth.

All asset and liability items contained in the financial statement of this report were examined and verified with relative emphasis according to their amounts and potential impact on surplus as regards policyholders. Additionally, an examination of the following items was made:

Company History	Charter and Bylaws	Management and Control
Corporate Records	Holding Company Structure	Fidelity Bond/Insurance
Employee Benefits	Territory	Plan of Operation
Loss Experience	Market Conduct Activities	Reinsurance
Actuarial Review	Statutory Deposits	Subsequent Events
Accounts and Records	Commitments/Contingencies	Pecuniary Interest
Commission Equity		

In the interest of making the examination more efficient, certain audit work performed by the Company's independent auditors was relied on.

The previous examination of the Company was made as of December 31, 1998, and resulted in a $423,901 decrease in surplus. Additionally, several recommendations were made as a result of non-compliance with regulatory requirements as follows:

1.) The Company leases certain computers, office equipment, and software from its parent company (CIG) under the terms of four operating leases. These leases have varying terms and require either monthly or quarterly payments to the parent company. As of December 31, 1998, the total monthly expenses incurred under these leases is $6,600. During 1998, the Company failed to request and get the Commissioner's approval for one of these operating leases that exceeded 3% of their total assets. This is a violation of T.C.A. 56-11-206(a)(2) – Intercompany transactions. The Company should get the Commissioner's approval in the future for any such transactions.

At December 31, 2002, the Company did not have any leases with its parent company. The Company leases it office facility and certain photocopier and mail equipment from commercial leasing companies, as described in this report under the heading Commitments and Contingencies.

2.) During the period under review, the Company's Board of Directors did not approve any of the investment transactions that occurred. This is a violation of T.C.A. 56-3-408 – Prohibited actions and transactions. This problem should be corrected as soon as possible.

The current examination revealed that all investment transactions are approved by the Board of Directors as stated in this report under the heading Corporate Records.

3.) The Company reported in their 1998 Annual Statement their total surplus as regards policyholders was $2,059,386. Examination adjustments decreased the Company's surplus by $423,901. Therefore, the Company's surplus as regards policyholders for this examination is $1,635,485. T.C.A. 56-2-114—115 requires an insurer of this Company's type to maintain a minimum capital and surplus of

$2,000,000. Therefore, the Company as of December 31, 1998, is impaired. It is recommended that the Company immediately take steps to increase their capital and surplus position to a level that is not considered impaired by TN Insurance Law.

On February 25, 1999, the Company was no longer impaired after it received additional surplus from its parent, as described in this report under the heading Company History.

COMPANY HISTORY

The Company was incorporated in Tennessee on August 9, 1994, as a wholly-owned subsidiary of Consumers Insurance Group, Inc. (CIG). The Company remained dormant until it was licensed as a Tennessee property and casualty insurance company on April 21, 1995.

The Company was incorporated as a perpetual for profit corporation under the provisions of the Tennessee General Corporation Act. Authorized capital stock was one thousand (1,000) shares of common capital stock with a par value of one thousand dollars ($1,000) per share. All shares were held by CIG on April 25, 1995, having been acquired at a purchase price of $2,865.00 per share. Thus, there was $1,000,000 in common capital stock and $1,865,000 in gross paid in and contributed surplus on the same date.

During February, 1999, CIG received net proceeds of approximately $4,194,000 as a result of a private placement offering of its preferred stock. On

February 25, 1999, the Company received $3,870,000 of these proceeds from CIG as additional paid-in surplus. A $242,200 surplus note payable to CIG and executed on June 29, 1998, was paid in full on June 10, 1999. The payoff of this surplus note was approved by the Tennessee Department of Commerce and Insurance on June 2, 1999.

Effective December 12, 2001, the Company's charter was amended and the new authorized capital stock became one thousand (1,000) shares of common capital stock with a par value of two thousand dollars ($2,000) per share.

At December 31, 2002, the Company's authorized capital stock was 1,000 shares of $2,000 par value common capital stock, of which 1,000 shares were outstanding.

The Company underwrites private passenger and commercial automobile insurance utilizing a network of independent agents throughout Tennessee and Missouri.

The Company's development, as taken from annual statement filings since the previous examination, is depicted in the following table:

Date	Gross Premiums Written	Gross Losses Paid	Net Income	Admitted Assets	Total Liabilities	Capital and Surplus
*12/31/98	6,517,377	3,115,830	(521,653)	4,533,855	2,474,469	2,059,386
12/31/99	11,147,843	8,062,692	(590,536)	8,598,403	3,709,323	4,889,080
12/31/00	11,284,219	8,986,484	(654,358)	8,558,659	4,419,766	4,138,893
12/31/01	13,301,108	7,715,295	420,659	11,397,052	6,691,195	4,405,857
12/31/02	20,148,580	10,816,289	1,059,555	16,254,923	10,576,333	5,678,589

*previous exam

CHARTER AND BYLAWS

Charter:

The general provisions and powers enumerated in the Company's charter are usual in nature consistent with corporations of this type. The Company's charter states the purpose for which the corporation is organized as follows:

> "To engage in the business of insurance, writing and issuing policies of insurance, all as allowed by Title 56 of the Tennessee Code Annotated, as the same may hereafter be amended, from time to time and as allowed in any other state, and to engage in any other lawful act or activity for which a Corporation may be organized under the Tennessee Business Corporation Act."

Bylaws:

The bylaws of the Company, as revised on July 31, 2002, are such as are generally found in corporations of this type. They are consistent with the charter and contain no unusual provisions. They provide for the regulation of the business and for the conduct of the affairs of the Company, the directors and the shareholders. The bylaws may be altered or amended by an affirmative vote of 66 2/3% of the entire Board of Directors or by the shareholders upon a vote of not less than 66 2/3% of the shares outstanding.

MANAGEMENT AND CONTROL

Management:

Management of the Company is vested in a Board of Directors which are elected annually by the stockholders. The Board of Directors of the Company will consist of not less than four nor more than seven. The duly elected directors serving at December 31, 2002, were as follows:

Name	Address	Occupation
L. W. Legge, Jr.	Cookeville, Tennessee	President, L.W. Legge Agency, Inc. (Insurance Agency)
William J. Wheeler, III	Brentwood, Tennessee	President, Consumers Insurance USA, Inc.
David A. Sciortino	Nashville, Tennessee	Executive VP, Cooper, Love & Jackson, Inc. (Insurance Agency)
Amanda C. Farnsworth	Nashville, Tennessee	Sr. VP, J.J.B. Hilliard, W.L. Lyons, Inc. (Investment Banking)

The bylaws provide that the Board of Directors, by resolution adopted by a majority of the whole Board, may appoint an Executive Committee consisting of not less than three directors, one of whom shall be designated as Chairman of the Executive Committee. The Board of Directors, by resolutions adopted by a majority of the whole Board, may appoint such other committee or committees as it shall deem advisable and with such functions and duties as the Board may prescribe. During the period under examination, no committees had been established.

The Board of Directors will elect officers of the Company. The Board may choose (but need not choose, except for the offices of President and Secretary) a Chairman of the Board, a President, a Chief Executive Officer, a Chief Operating Officer, a Vice-President or Vice-Presidents, a Secretary, a Treasurer, a Chief Financial Officer, one or more Assistant Secretaries and/or Treasurers and other officers and agents as it shall deem necessary or appropriate. The duly elected officers of the Company at December 31, 2002, were as follows:

Name	Office Held
L. W. Legge, Jr.	Chairman of the Board of Directors
William J. Wheeler, Jr.	President and Chief Operating Officer
David A. Sciortino	Secretary
Amanda C. Farnsworth	Treasurer
Dennis W. Kunkel	Chief Financial Officer

The Company has no employees of its own. Personnel and services are provided by the Company's parent, CIG, in accordance with a Service Agreement as described in this report under the heading Holding Company Structure.

Directors and officers of the Company are required annually to complete a "Conflict of Interest Disclosure." The examiners reviewed the disclosures completed by the directors and officers and no exceptions were noted.

Pecuniary Interest:

A check for compliance with Tenn. Code Ann. § 56-3-103 found that no director or officer of the Company had pecuniary interest in the investment or disposition of Company funds.

Control:

At December 31, 2002, 100% of the outstanding shares of the Company were owned by CIG, the Company's parent. The following dividends were paid by the Company during the examination period:

Year	Paid To	Amount
2002	Consumers Insurance Group, Inc.	$100,000

The above dividend was an ordinary dividend that did not require approval.

CORPORATE RECORDS

The minutes of the meetings of the Stockholders and Board of Directors were reviewed for the period under examination. They were found to be complete as to necessary detail and appear to adequately reflect the acts of the respective bodies. The review of the minutes indicates that the previous examination report was reviewed by and all investment transactions were approved by the Board of Directors.

HOLDING COMPANY STRUCTURE

An organizational chart of the Company and its parent is located on page 36 of this examination report. The following agreement between the Company and its parent was in effect at December 31, 2002:

Service Agreement:

The Company entered into a Service Agreement with its parent, CIG effective January 1, 2002. The agreement automatically renews annually unless terminated by either party. Under the terms of the agreement, CIG will provide to the Company the following services:

- supervise the underwriting, acceptance, and rejection of applications for insurance;
- review qualifications and screen applicants for agents' licenses, appoint and train agents; however, such agents will not be considered agents of CIG;
- prepare and file rates and forms for insurance where such filings are required by law or regulation;
- review, process, adjust claims, arrange for defense when claims cannot be adjusted, and maintain claim files;
- prepare accounting statements in sufficient detail to comply with regulatory and reinsurance contract reporting requirements, and submit invoices to reinsurers;
- prepare quarterly and annual financial and informational statements to be filed with regulators;
- prepare premium tax returns and any regulatory reports as may be necessary;
- arrange for such legal, accounting, actuarial, investment and other professional services as may be reasonably required for the conduct of the business;
- perform such other services as the parties shall from time to time agree upon as being necessary and appropriate supplements to the services, and

- indemnify and defend against any claim, suit or proceeding arising out of any alleged wrong or error to any third party in performing the services required under the agreement.

In consideration of the services provided, the Company compensates CIG quarterly for actual costs incurred in the provision of such services plus a monthly management fee of $8,333.

Pursuant to Tenn. Code Ann. § 56-11-206(a)(2)(D), the Service Agreement was filed with the Tennessee Department of Commerce and Insurance on October 1, 2001, and was deemed approved since the Commissioner did not disapprove within thirty days.

FIDELITY BOND AND OTHER INSURANCE

The Company is listed as a named insured on the following insurance coverages maintained by CIG at December 31, 2002:

Commercial Property	Commercial General Liability
Employee Benefits Liability	Commercial Inland Marine

In addition to the above coverages, CIG maintained a Fidelity Bond and Directors & Officers Liability insurance; however, the Company was not a named insured. The Company was added as a named insured effective January 1, 2003. The fidelity coverage is in excess of the suggested minimum amount per the NAIC Financial Condition Examiners Handbook. All of the above insurance policies are written by companies licensed to write in Tennessee.

EMPLOYEE BENEFITS

The Company has no employees of its own. Personnel and services are provided by the Company's parent, CIG, in accordance with a Service Agreement as described in this report under the heading Holding Company Structure.

TERRITORY

As of December 31, 2002, the Company was licensed to transact business in Indiana, Kentucky, Mississippi, Missouri and Tennessee; however, they are only active in Missouri and Tennessee. Certificates of authority, for the various jurisdictions, were reviewed and found to be valid. Additionally, a letter was sent to each state in which the Company does business inquiring about any non-compliance concerns. No material concerns were received. Premiums written during 2002, by state, are as follows:

State	Direct Premiums Written	Direct Premiums Earned	Dividends Paid or Credited to Policyholders on Direct Business	Direct Losses Paid	Direct Losses Incurred	Direct Losses Unpaid	Finance and Service Charges not Included in Premiums
Missouri	$ 205,903	$ 70,783	$0	$ 3,738	$ 7,296	$ 3,560	$ 2,411
Tennessee	19,242,677	17,780,947	0	10,812,552	12,132,719	4,251,030	2,219,431
Totals	$20,148,580	$17,851,730	$0	$10,816,920	$12,140,017	$4,254,590	$2,221,842

Note: all other states and territories have zero (0) amounts

PLAN OF OPERATION

The Company operates principally in the commercial and private passenger automobile markets. The Company's products are sold by a force of approximately 200 independent agencies. The Company does not have any Managing General Agents or Third Party Administrators.

The Company offers three tiers of private passenger automobile coverage; Standard, Preferred, and Elite. These tiers offer different maximum limits and rates based on the insured's driving record, type of automobile, etc. All private passenger policies are written for a six-month term.

The Company's commercial program includes Business Automobile, Auto Dealer, Garage Repair, Property, and Towing coverages. All commercial policies are written for a twelve-month term.

The following schedule depicts business in force at December 31, 2002:

Policy Type	Policies In-Force	%	Premiums In-Force	%
Standard	7,224	34.8%	$3,129,119	23.1%
Preferred	2,156	10.4%	955,673	7.1%
Elite	7,509	36.2%	3,147,627	23.3%
Business Auto	1,803	8.8%	2,627,102	19.4%
Auto Dealer	845	4.1%	2,238,174	16.6%
Garage Repair	379	1.8%	294,635	2.2%
Property	608	2.9%	329,881	2.4%
Towing	213	1.0%	800,043	5.9%
Totals	20,737	100%	$13,522,254	100%

MARKET CONDUCT ACTIVITIES

A market conduct review of the Company was made concurrently with the financial condition examination. The following areas were covered by this review.

Advertising:

The Company maintains a website where persons can find general information about the company; find agents; request quotes and find links to various resources. The Company's printed advertising consists of brochures and pamphlets used for marketing by the independent agencies.

Underwriting:

Principal underwriting functions are performed by the contracted independent agencies. These functions include risk selection and modification, risk classification, and rate determination based on the Company's written underwriting guidelines. The Company's Web-based system allows the agencies to issue policy declaration pages and identification cards directly to the insured.

Rates and Policy Forms:

At December 31, 2002, the current personal lines rates effective September 1, 2002, for new business and November 1, 2002, for renewal business were duly filed with the Tennessee Department of Commerce and Insurance on July 18, 2002, and approved on August 1, 2002.

At December 31, 2002, the current commercial lines rates effective November 1, 2002, for new business were duly filed with the Tennessee Department of Commerce and Insurance on December 9, 2002, and approved on December 10, 2002.

At December 31, 2002, the current commercial lines rates effective January 1, 2002, for renewal business were duly filed with the Tennessee Department of Commerce and Insurance and approved on January 17, 2002.

On June 12, 1998, the Tennessee Department of Commerce and Insurance approved the Company's use of ISO policies and endorsements. The Company utilizes the most current ISO versions that are filed with the state.

Complaints:

The Company has written procedures on how complaints are to be handled. A review of complaints made to regulatory authorities regarding the Company indicates a conscientious effort by the Company to equitably fulfill its obligations and to resolve policyholder complaints in a timely manner.

Claims:

All claims are handled by the Company's parent, CIG, pursuant to a Service Agreement described in this report under the heading Holding Company Structure. CIG maintains a comprehensive claims procedures manual. This manual was reviewed and no exceptions were noted. A sample of open and closed claims reviewed during the examination indicated that claims were being paid in accordance with policy provisions and settlements were promptly made upon receipt of proper evidence of the Company's liability.

Privacy:

The Company has a written "Notice of Privacy Policy" which complies with Tenn. Comp. R. & Reg. §0780-1-72.

LOSS EXPERIENCE

The loss experience of the Company, since the previous examination, as reported in its annual statements, is as follows:

Year	Losses Incurred	LAE Incurred	Premiums Earned	Loss Ratio
1999	$ 5,472,999	$ 586,248	$ 6,618,990	91.5%
2000	6,596,001	698,862	7,562,871	96.5%
2001	5,609,408	899,668	8,299,601	78.4%
2002	7,699,987	1,244,965	12,094,346	74.0%
Total	$25,378,395	$3,429,743	$34,575,808	83.3%

REINSURANCE

The Company routinely cedes reinsurance with other insurance companies. All material reinsurance agreements were reviewed and found to contain all of the standard clauses. There were no treaties with any unusual provisions and all treaties provide for a transfer of risk. As of December 31, 2002, all companies, including Lloyds Syndicates, to whom business is ceded are authorized. The following is a summary of the current reinsurance agreements at December 31, 2002:

(1)

Type:	Multi-Line Quota Share
Reinsurer:	Motors Insurance Corp.
Business Covered:	Commercial and Private Passenger Automobile Bodily Injury and Property Damage Liability (including Personal Injury Protection, Medical Payments and Uninsured/Underinsured Motorists). Commercial and Private Passenger Automobile

	Physical Damage, Dealer Open Lot Coverage, Garage Coverage (including Garage Liability, Garage Keepers Coverage and Garage Physical Damage Coverage) and Commercial Property including Fire and Allied Lines.
Retention:	Company retains 70% of its net liability and cedes 30%
Loss Retention Corridor:	Company retains 100% of losses incurred in excess of an amount equal to 77% of premiums earned not to exceed an amount equal to 100% of 7% of premiums earned.
Commission:	20% Provisional Commission adjusted annually as follows: If loss ratio is 73% or greater, adjusted rate is 20%. The difference in the actual loss ratio and 73% is multiplied by premiums earned and carried forward to next adjustment period as a debit to losses incurred. If loss ratio is less than 73% but not less than 60%, adjusted rate is 20% plus the difference in the actual loss ratio and 73%. If loss ratio is less than 60%, the difference in actual loss ratio and 60% is multiplied by premiums earned and carried forward to next adjustment period as a credit to losses incurred.
Commission Equity:	Unearned commissions at December 31, 2002 were $402,743. This amount has been established as a liability on the Company's financial statement.
Warranty:	The Company is required to carry excess of loss and excess catastrophe reinsurance, recoveries under which shall inure to the benefit of this contract.

Term:	Continuous effective January 1, 2000. May be terminated at the end of any calendar year with 90 days prior notice.

(2)

Type:	Multi-Line Excess of Loss
Reinsurer:	Motors Insurance Corp.
Business Covered:	Commercial and Private Passenger Automobile Bodily Injury and Property Damage Liability (including Personal Injury Protection, Medical Payments and Uninsured/Underinsured Motorists). Commercial and Private Passenger Automobile Physical Damage, Dealer Open Lot Coverage, Garage Coverage (including Garage Liability, Garage Keepers Coverage and Garage Physical Damage Coverage) and Commercial Property including Fire and Allied Lines.
Retention and Limit:	Coverage A – Casualty: \$900,000 excess of \$100,000 ultimate net loss each occurrence Coverage B – Property: \$900,000 excess of \$100,000 ultimate net loss each risk. Limit of \$1,800,000 all risks in any one occurrence. Coverage C – Combined Casualty and Property: \$100,000 excess of \$100,000 ultimate net loss each occurrence. Coverages A and B inure to the benefit of Coverage C.
Premium:	Annual minimum deposit premium of \$295,000 adjusted at year end to include the amount by which 2.6% of gross net earned premium income exceeds \$295,000.
Term:	Continuous effective January 1, 2000. May be terminated at

the end of any calendar year with 90 days prior notice.

(3)

Type:	Catastrophe Excess
Reinsurer:	Various Lloyds Syndicates
Business Covered:	Commercial and Private Passenger Automobile Physical Damage and Commercial Multiple Peril.
Retention and Limit:	

Layer	Company Retention Ultimate net loss in respect of each loss occurrence	Reinsurers Limit Ultimate net loss in respect of each loss occurrence
First Excess	$150,000	97.5% of $150,000
Second Excess	$300,000	97.5% of $500,000
Third Excess	$800,000	97.5% of $1,250,000

Premium:	First Layer: .4985% of net written premium income subject to a deposit premium of $14,627. Minimum premium of $11,701. Second Layer: .7620% of net written premium income subject to a deposit premium of $22,358. Minimum premium of $17,886. Third Layer: .8310% of net written premium income subject to a deposit premium of $24,383. Minimum premium of $19,506.
Term:	Effective January 1, 2002 to January 1, 2003

INDEPENDENT ACTUARIAL REVIEW

An independent actuarial review was performed by Agee Fisher, LLC, Atlanta, Georgia. This included a review of the actuarial reports prepared by the Company's actuarial consultants and an assessment of the reasonableness of the methodologies and assumptions used in the projection of ultimate loss and loss adjustment expenses. Based on the results of the review and an evaluation of key ratios, a range of loss and loss adjustment expense reserve estimates was prepared and compared to the Company's recorded loss and loss adjustment expense reserves at December 31, 2002.

STATUTORY DEPOSITS

The Company maintained the following deposits at December 31, 2002:

Where Deposited and Description	Par Value	Statement Value	Market Value
Missouri			
USTN, 3.625%, Due 8/31/03	$600,000	$603,051	$609,564
Tennessee			
USTN, 6%, Due 8/15/04	600,000	637,968	644,250
Overton Co., 4.85%, Due 6/1/09	100,000	103,812	107,880
Clarksville, 6.25%, Due 6/1/04	190,000	195,106	201,666
TN St, 6%, Due 2/1/06	325,000	336,710	355,680
TN St Sch Bd, 5.90%, Due 5/1/09	300,000	297,550	327,660
Totals	$2,115,000	$2,174,197	$2,246,700

Note: the Tennessee deposit is a general deposit

The above deposits were verified by direct correspondence with the regulating jurisdiction.

The Missouri deposit is admitted even though the liability in Missouri is less than the deposit. The difference is immaterial to the examination. Premiums written in Missouri increased from $205,903 in 2002 to $2,408,598 in 2003.

COMMITMENTS AND CONTINGENCIES

The Company leases certain office equipment from commercial leasing companies under four separate leases as follows:

Lease Start	Term	Payment Terms	Payment Amount
March, 1998	60	Monthly	$ 139.29
July, 1998	60	Monthly	224.43
January, 2001	36	Monthly	710.00
January, 2001	60	Monthly	1,329.00

A five year lease for office space was entered into on March 1, 2001. The lease requires monthly payments of $4,291.67 for the first year; $4,398.96 per month for the second and third years; and $4,506.25 per month for the fourth and fifth years. The Company has the option to extend for an additional term at a rate to be negotiated at the time of renewal.

From the examination data made available, it appears that the only matters of law in which the Company was involved, during the period under review, were those arising out of the normal course of business and the outcome of such actions should not have a material effect on the financial position of the Company.

ACCOUNTS AND RECORDS

During the course of examination, such tests and audit procedures were made as were considered necessary, including substantial verification of postings, extensions and footings. General ledger trial balances were reconciled with copies of annual statements for the years 1999, 2000, 2001 and 2002.

The Company is in compliance with Tenn. Comp. R. & Reg. §0780-1-46 with respect to the custody of its securities. Additionally, the Company is in compliance with Risk-Based Capital requirements.

Accounting records conform to generally accepted insurance accounting practices and appear to properly reflect the operations during the period under examination and the status of the Company at the date of examination.

The Company is audited annually by Crowe Chiezek and Company, LLC., (formerly known as Kruse & Associates, PC) Brentwood, Tennessee. This firm has been performing the annual audit of the Company since 2000; therefore, there is no violation as respects Tenn. Comp. R. & Reg. §0780-1-65.07(3).

SUBSEQUENT EVENTS

In September, 2003, the Company's parent borrowed $2,000,000 and contributed $1,980,000 of those funds to the Company as paid in surplus. Additionally, in October, 2003, the parent made a stock offering which raised approximately $2,148,088 and contributed $1,900,000 of those funds to the

Company as paid in surplus.

On October 22, 2003, the Company entered into a Tax Sharing Agreement with its parent. The consolidated tax liability is allocated to each member of the consolidated group based upon the percentage of each member's tax, computed on a separate return basis, to the total return so computed for all members. Intercompany balances are adjusted within 60 days after the consolidated tax return is filed.

Pursuant to Tenn. Code Ann. § 56-11-206(a)(2)(D), the Tax Sharing Agreement was filed with the Tennessee Department of Commerce and Insurance on October 27, 2003 and approved on December 2, 2003.

FINANCIAL STATEMENT

There follows a statement of assets, liabilities and statement of income at December 31, 2002, together with a reconciliation of capital and surplus for the period under review, as established by this examination:

ASSETS

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	$ 8,961,654		$ 8,961,654
Cash and short-term investments	1,291,043		1,291,043
Total cash and invested assets	10,252,697		10,252,697
Premiums and agents' balances in course of collection	148,234	$ 4,712	143,522
Premiums, agents' balances and installments booked but deferred	4,525,139		4,525,139
Reinsurance recoverables on loss and lae payments	703,723		703,723
Federal income tax recoverable	440,586		440,586
Guaranty funds receivable/on deposit	2,592		2,592
Interest due and accrued	152,800		152,800
Aggregate write-ins for other than invested assets:			
Miscellaneous assets	33,873		33,873
Totals	$16,259,634	$ 4,712	$16,254,922

LIABILITIES, SURPLUS AND OTHER FUNDS

Losses	$ 3,152,511
Loss adjustment expenses	243,094
Commissions payable, contingent commissions	773,605
Other expenses	542,699
Unearned premiums	4,698,667
Advance premiums	165,556
Ceded reinsurance premiums payable	1,410,581
Amounts withheld or retained by company for account of others	3,024
Payable to parent, subsidiaries and affiliates	1,675
Total liabilities	10,991,412
Common capital stock	2,000,000
Gross paid in and contributed surplus	4,735,000
Unassigned funds	(1,471,490)
Surplus as regards policyholders	5,263,510
Totals	$16,254,922

UNDERWRITING AND INVESTMENT EXHIBIT

STATEMENT OF INCOME

Underwriting Income	
Premiums earned	$12,094,346
Deductions	
Losses incurred	8,083,518
Loss expenses incurred	1,276,513
Other underwriting expenses incurred	4,674,575
Total underwriting deductions	14,034,606
Net underwriting gain or (loss)	(1,940,260)
Investment Income	
Net investment income earned	377,109
Net realized capital gains or (losses)	(9,130)
Net investment gain or (loss)	367,979
Other Income	
Net gain (loss) from agents' or premium balances charged off	(5,085)
Finance and service charges not included in premiums	2,221,842
Total other income	2,216,757
Net income before federal income tax	644,476
Federal income taxes incurred	0
Net income	$ 644,476

RECONCILIATION OF CAPITAL AND SURPLUS
FOR THE PERIOD UNDER EXAMINATION

Surplus as regards policyholders, December 31, 1998	$2,059,386
Net income	(590,538)
Change in non-admitted assets	17,036
Change in excess of statutory reserves over statement reserves	(30,520)
Change in surplus notes	(242,200)
Paid in surplus	3,870,000
State audit adjustment prior year	(194,083)
Change in surplus as regards policyholders for the year	2,829,695
Surplus as regards policyholders, December 31, 1999	$4,889,081
Net income	(654,358)
Change in non-admitted assets	(126,349)
Cumulative effect of changes in accounting principles	30,520
Change in surplus as regards policyholders for the year	(750,187)
Surplus as regards policyholders, December 31, 2000	$4,138,894
Net income	420,660
Change in non-admitted assets	111,235
Capital paid in	1,000,000
Surplus paid in	(1,000,000)
Aggregate write-ins for gains and losses in surplus:	
Unearned reinsurance commission	(264,932)
Change in surplus as regards policyholders for the year	266,963
Surplus as regards policyholders, December 31, 2001	$4,405,857
Net income	644,476
Change in net deferred income tax	440,586
Change in non-admitted assets	10,402
Dividends to stockholders	(100,000)
Aggregate write-ins for gains and losses in surplus:	
Unearned reinsurance commission	(137,811)
Change in surplus as regards policyholders for the year	857,653
Surplus as regards policyholders, December 31, 2002	$5,263,510

ANALYSIS OF CHANGES IN FINANCIAL STATEMENT AND COMMENTS RESULTING FROM EXAMINATION

Losses	$3,152,511
Loss adjustment expenses	$ 243,094

The above amounts are $383,531 and $31,548 respectively, more than reported by the Company in its 2002 annual statement. These adjustments are made pursuant to the independent actuarial review made by Agee Fisher, LLC. Based on the review, it was determined that recorded reserves fell below a reasonable range of reserves for claims incurred on or before December 31, 2002.

Unassigned funds	($1,471,490)

The above amount is $415,079 less than reported by the Company in its 2002 annual statement. The difference, as it relates to the items previously indicated, is outlined in the schedule on the following page.

SUMMARY SCHEDULE FOR "ANALYSIS OF CHANGES IN FINANCIAL STATEMENT AND COMMENTS RESULTING FROM EXAMINATION" AS THEY AFFECT SURPLUS

Item	Change in Surplus	
	Increase	Decrease
Losses		$ 383,531
Loss adjustment expenses		31,548
Total		$ 415,079
Net Change in Surplus		$ 415,079

COMMENTS AND RECOMMENDATIONS

Comments:

1. At December 31, 2002, the Company's in-force database included policies that were written in 2002 but had effective dates in 2003. The computer system was recognizing these policies as active even though they had future effective dates. Additionally, the system was recognizing renewals as active when the renewal down payment was made even though the renewal had a future effective date. Although the amount of the discrepancy was not material to the examination, the issue was brought to the attention of Company management and a programming change was made to alleviate the discrepancy from happening again.

2. At December 31, 2002, the Company's unearned premium database was in error. There were 9 policies included in the database which had endorsements prior to year end but the effective dates for the endorsements were in 2003. Although the amount of the discrepancy was not material to the examination, the issue was brought to the attention of Company management and a programming change was made to alleviate this discrepancy in the future.

3. The Company's federal income tax return is consolidated with its parent; however, there was no tax allocation agreement in effect at December 31, 2002. The Company was advised to draw up an agreement and submit it the Tennessee Department of Commerce and Insurance in accordance with Tenn. Code Ann. § 56-11-206(a)(2)(D). A Tax Sharing Agreement

was executed and submitted on October 27, 2003.

4. At December 31, 2002, the Company was not a named insured on the fidelity bond coverage carried by its parent. This was corrected effective January 1, 2003.

5. At December 31, 2002, the Company's Anti-Fraud Plan did not contain procedures for reporting insurance fraud to appropriate law enforcement and regulatory authorities as required by Tenn. Code Ann. § 56-53-111(a)(1)(D). Prior to completion of the examination, the Anti-Fraud Plan was amended to include said procedures.

6. On December 31, 2001, the Company's charter was amended to change the par value of its common stock from $1,000 to $2,000 per share; however, a new stock certificate was never issued to the Company's sole owner. Prior to completion of the examination, a new stock certificate was issued.

<u>Recommendations:</u>

1. The following inaccuracies were found in the Company's 2002 annual statement:

   (a) on Schedule D, on a few occasions, the Company is reporting bond acquisitions on the settlement date instead of the trade date

   (b) note 13B, in the Notes to Financial Statements, states that no dividends were paid in 2002; however, a dividend of $100,000 was paid in 2002

(c) note 15, in the Notes to Financial Statements, describes an equipment lease that is no longer in effect; additionally, the Company has four equipment leases that are not disclosed
(d) note 23A, in the Notes to Financial Statements, states that there are reinsurance recoverables from two reinsurers that exceed 3% of surplus; however, it should state one reinsurer
(e) on Schedule F, the Company lists GMAC Re as a reinsurer when in fact it should be Motors Insurance Corp
(f) on Schedules D and DA, the Company is listing their custodian, AmSouth, in the "Vendor" column when they should be disclosing the name of the broker

Based on the above inaccuracies, it is recommended that the Company comply with Tenn. Code Ann. § 56-1-501(g) when completing its annual statement to alleviate discrepancies.

2. During the course of the examination it was discovered that applications for insurance were being maintained by the independent agents. When a sample of applications were selected to be reviewed, approximately 11% of the applications could not be found or had been destroyed.

   Therefore, it is recommended that the Company keep the original signed applications for insurance at its office to maintain control over said documents. Additionally, applications should be maintained by the Company at its office pursuant to Tenn. Code Ann. § 56-1-411(b)(1) and Tenn. Code Ann. § 56-2-104(a)(5).

CONCLUSION

The customary insurance examination practices and procedures, as established by the National Association of Insurance Commissioners, have been utilized in connection with the verification and valuation of assets and the determination of liabilities in the financial statement of this report.

In such manner, it was determined that, as of December 31, 2002, the Company had net admitted assets of $16,254,922 and liabilities, exclusive of capital, of $10,991,412. Thus, there existed for the additional protection of the policyholders, the amount of $5,263,510 in the form of paid-up capital, gross paid-in and contributed surplus and unassigned funds (surplus).

In addition to the undersigned, Brett E. Miller, FCAS, MAAA, FCA of Agee Fisher, LLC, Atlanta, Georgia, participated in the work of this examination.

Respectfully submitted,

David R. White, CFE
Examiner-in-Charge
State of Tennessee
Southeastern Zone, NAIC

Donnie R. Nicholson
Examiner III
State of Tennessee
Southeastern Zone, NAIC

Bryant Cummings
Examiner II
State of Tennessee
Southeastern Zone, NAIC

AFFIDAVIT

The undersigned deposes and says that he has duly executed the attached examination report of Consumers Insurance USA, Inc. dated April 29, 2004, and made as of December 31, 2002, on behalf of the Tennessee Department of Commerce and Insurance. Deponent further says he is familiar with such instrument and the contents thereof, and that the facts therein set forth are true to the best of his knowledge, information and belief.

David R. White, CFE
Examiner-in Charge
State of Tennessee
Southeastern Zone, NAIC

Subscribed and sworn to before me this

29th day of April, 2004

Notary Helen M. Dorsey

County Davidson

State Tennessee

Commission Expires 03/25/06

ORGANIZATIONAL CHART